Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Deployment of Wireline Services Offering	)	CC Docket No. 98-147
Advanced Telecommunications Capability	)	

COMMENTS OF U S WEST COMMUNICATIONS, INC.

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SUMMARY

This proceeding presents an important opportunity for the Commission to fulfill its mandate under section 706 of the 1996 Act: encouraging the deployment of advanced telecommunications services to *all* Americans. Large cities and big businesses already have access to a wide array of broadband data services; the challenge confronting the Commission is to enable carriers to bring such services to smaller and more rural communities. The Commission will accomplish that objective only if it both permits incumbent LECs to take advantage of the efficiencies associated with integrated provision of voice and data services and declines to extend unbundling and resale obligations to the nonbottleneck equipment used to provide advanced services.

Granting incumbent LECs freedom from unbundling and resale obligations with respect to *nonbottleneck* equipment will not hamper competition. The Commission's existing rules ensure the availability of loops and collocation, the essential inputs needed by new entrants. Other advanced services equipment, such as DSLAMs and ATMs, is readily available to new entrants on the open market and need not be obtained from incumbent LECs. Indeed, requiring incumbents to turn over such nonbottleneck equipment to competitors would destroy the incumbents' incentives to invest and innovate and would dissuade new entrants from investing in their own facilities.

The availability of bottleneck facilities pursuant to sections 251 and 252, coupled with nonstructural safeguards that prevent anticompetitive conduct, makes structural separation unnecessary. Conditioning the grant of regulatory relief on creation of a separate affiliate, moreover, would fail to tap the unmatched potential of incumbent LECs to deliver advanced services over their extensive existing facilities to the mass market. As the Commission has

recognized previously, structural separation greatly inhibits the rollout of new services because it imposes tremendous costs. Most significantly, the inefficiency of structural separation would prevent carriers from deploying advanced services to smaller and more rural communities, which are too costly to serve absent the economy of integrated operations.

Even if the benefits of structural separation otherwise outweighed its costs, providing service through a separate affiliate would be a practical impossibility for U S WEST under the regime proposed here. The NPRM tentatively concludes that incumbents cannot transfer existing facilities to an affiliate without making the affiliate an assign (and, in turn, subjecting the affiliate to incumbent LEC regulation). Because U S WEST has been an industry leader in actually deploying advanced services capability, any such rule would punish U S WEST for its competitive initiatives. Thus, in the event the Commission adopts the NPRM's structural separation proposal, U S WEST will derive no benefit from a separate affiliate scheme unless the Commission both permits asset transfers without making the affiliate an assign and preempts any state law that interferes with that process.

Finally, the Commission should not adopt the bulk of its proposed "Measures to Promote Competition in the Local Market." Whatever else results from this proceeding, the Commission should not impose *new* regulatory burdens on incumbent LECs. While disputes may arise between incumbents and new entrants regarding collocation and loop-related issues, the marketplace would benefit far more from tailored agreements that reflect local needs and facilities than from one-size-fits-all solutions that are centrally imposed by the Commission. The statutory mediation and arbitration process was designed for just this purpose.

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U S WEST Communications, Inc. ("U S WEST") hereby submits these comments in response to the Commission's Notice of Proposed Rulemaking in the above-captioned docket.

PRELIMINARY STATEMENT

The NPRM loses sight of how and why this proceeding began. It started as a bold initiative to part with the past and recognize the power of the market in developing and distributing advances in telecommunications services. As Congress recognized in drafting section 706 of the Telecommunications Act of 1996, the market, rather than regulation, is best suited to "encourage the deployment on a reasonable and timely basis of advanced telecommunications capability to all Americans." Accordingly, seven months ago, four telecommunications carriers and a public interest organization petitioned the Commission to forbear from various regulatory requirements that hamper the growth of the advanced services. U S WEST and other incumbent LECs demonstrated to the Commission that, by forbearing from applying unbundling and resale requirements in the advanced service context, and permitting incumbent LECs to build high-speed data networks across LATA boundaries, the Commission

could dramatically enhance the deployment of such services in more rural and less populated markets and increase competition for such services generally.

The Commission declined to grant such relief. Instead, in an NPRM promulgated with the denial, the Commission has proposed imposing even more regulation of advanced services provided by incumbent LECs. It departs entirely from the deregulatory, procompetitive spirit of section 706 in order to favor specific competitors. And while the NPRM proposes some regulatory relief, it does so only in tandem with a new requirement of structural separation that in fact will stymie rather than encourage the deployment of advanced services.

Conditioning regulatory relief on structural separation is doomed to fail: Denying incumbents the benefits of integrative efficiencies would remove both their ability and incentive to fulfill their potential to bring advanced services to the mass market. Discarding such efficiencies would simply advance the narrow interest of new competitors, without having any positive effect on competition generally. This is neither what Congress desired nor what the market requires.

The NPRM appears to have proposed structural separation based on a perceived (but false) choice between tapping incumbents' unmatched potential to deploy advanced services to all Americans and leveling the playing field for all competitors. In fact, the Commission can *both* facilitate the deployment of advanced services *and* protect competition. By permitting incumbent LECs to provide advanced services free from unbundling obligations on an integrated basis, the Commission will allow them to achieve considerable efficiencies and thereby introduce advanced services to small and rural communities that otherwise will be unserved. At the same time, relieving incumbents of the burdens of unbundling and resale obligations with respect to *nonbottleneck* facilities poses no threat to competition.

The central flaw in the NPRM stems from a failure to recognize that giving incumbent LECs this freedom will not hamper competition. The advanced services market will be competitive if bottleneck facilities and collocation are made available to all carriers. Because U S WEST and other incumbents make loops and collocation available, they have no technical or economic advantages over new entrants in providing advanced services. The Commission's existing regulations already ensure the availability of these essential inputs. The Commission therefore should not extend *new* unbundling obligations in the advanced services context; such a decision would serve no procompetitive purpose and certainly would not empower or encourage the incumbents to offer services to their rural and small town customers. For similar reasons, the Commission should not adopt the bulk of its proposed "Measures to Promote Competition in the Local Market." The marketplace would benefit far more from tailored agreements that reflect local needs and facilities than from one-size-fits-all solutions centrally imposed by the Commission. The statutory mediation and arbitration process was designed for just this purpose.

Indeed, imposing new unbundling obligations and other regulatory requirements on an incumbent LEC that chooses to provide advanced services on an integrated basis would ensure that the carrier invests sparingly, if at all, in the rural and smaller communities that new entrants have scrupulously avoided. Regardless of any Commission action in this proceeding, the top echelons of the advanced services market — areas with large urban populations and big businesses — will be fiercely competitive. The lure of substantial profits makes that a certainty. The challenge confronting the Commission is to find a way to bring competition to the *rest* of the consumer market. Forcing incumbents to behave like new entrants, far from helping achieve that goal, would preserve the status quo of selective deployment of advanced services.

I. THE COMMISSION SHOULD ALLOW INCUMBENT LECS TO PROVIDE ADVANCED SERVICES ON AN INTEGRATED BASIS FREE FROM ANY NEW UNBUNDLING AND RESALE OBLIGATIONS.

The 1996 Act directs that the Commission encourage, not discourage, the deployment of new technologies and advanced services. Act § 706. Both this policy and the Commission's rules make clear that incumbent LECs need not and should not be compelled to turn over to competitors the nonbottleneck facilities used to provide advanced services. In the *Advanced Services Order*,[1/] the Commission ruled that section 251 applies to advanced services facilities,[2/] but the Commission has not yet decided what "specific unbundling requirements [it] should impose on network elements used by incumbent LECs in the provision of advanced services." *Advanced Services NPRM* ¶ 180; *see also Advanced Services Order* ¶ 58. Nor has the Commission decided whether the resale requirement in section 251(c)(4) applies to advanced services to the extent that such services are exchange access services. *Advanced Services NPRM* ¶ 188.

The Commission should not impose *any* unbundling requirements beyond those already in place. *See* Part I.A. Under the Act and the Commission's interpretations, unbundling is appropriate only for critical bottleneck elements. Advanced electronics such as DSLAMs,

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1/ *Deployment of Wireline Services Offering Advanced Telecommunications Capability*, FCC 98-188, CC Docket Nos. 98-147 *et al.* (rel. Aug. 7, 1998) ("*Advanced Services Order*"). U S WEST refers to the Notice of Proposed Rulemaking issued in this docket as "*Advanced Services NPRM*" or "NPRM."

2/ In its original Petition for Relief under section 706, U S WEST argued that the unbundling and resale obligations imposed in section 251 do not apply to the provision of advanced services because they are neither telephone exchange services nor exchange access services, and because the Commission in any event should forbear from applying sections 251(c)(3) and (4) under its section 706 authority. *See Petition of U S WEST Communications, Inc. for Relief from Barriers to Deployment of Advanced Telecommunications Services*, at 45-47 & n.24 (Feb. 25, 1998) ("*U S WEST Petition for Relief*").

ATM switches, and other packet-switching equipment are not bottleneck elements because they are readily available to all carriers on the open market. Such commercial availability undermines any purported justification for requiring incumbents to make available those portions of their own data networks. Regulation of these electronics also would flout the Commission's charge under section 706 to facilitate the deployment of advanced services to all Americans. *See* Part I.B.

Nor should the Commission find that advanced services provided to ISPs are subject to the resale requirement of section 251(c)(4). *See* Part I.C. U S WEST believes that it does not function as an incumbent LEC in providing advanced services because such services are neither *telephone exchange* services nor *exchange* access services.[3/] If one of those two characterizations must be applied, however, the fact that Internet service providers ("ISPs") represent virtually the entire subscriber base of U S WEST's MegaCentral service indicates that such advanced services are *access* services that are far more comparable to "exchange access" services than "telephone exchange" services. ISPs purchase wholesale access to U S WEST's advanced services in precisely the same manner that interexchange carriers purchase wholesale access to U S WEST's telephone exchange services. There is no valid reason to treat these two types of access services any differently for regulatory purposes.

A. Unbundling of Nonbottleneck Advanced Services Is Not and Should Not Be Required under Section 251.

Congress required in the 1996 Act that incumbent LECs unbundle those facilities a competitor truly needs to obtain from the incumbent in order to compete. It gave the Commission discretion to "determin[e] what network elements should be made available" among

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3/ *U S WEST Petition for Relief* at 45-47 & n.24; 47 U.S.C. § 153(26).

those potentially subject to unbundling. 47 U.S.C. § 251(d)(2). Congress specifically provided two critical factors that the Commission "*shall* consider, *at a minimum*": whether the failure to provide access to particular network elements would "impair" the ability of requesting carriers to provide service, and, in the case of proprietary elements, whether unbundled access to the elements in question is "necessary." *Id.* (emphasis added). Accordingly, whether a competitor is entitled to an incumbent's facilities depends on whether the competitor can reasonably obtain a substitute facility elsewhere or build the facility itself. The closely analogous "essential facilities" doctrine in antitrust law is founded on the same principle: An incumbent should be forced to turn over a facility for use by competitors only if it is not "available from another source or capable of being duplicated by the [competitor] or others." 3A, Philip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 773b (1996).[4/] If the facility is readily available in the competitive marketplace, requiring the incumbent to share the facility serves no procompetitive purpose. Indeed, it undercuts competition by destroying the incentives of the incumbent and entrant to invest and innovate. *See* Part I.B.

Chairman Kennard has repeatedly recognized that incumbent LECs, as broadband network providers, should be required to make only essential or bottleneck facilities available to competitors. In a speech this summer, the Chairman concluded that competition in advanced services requires "[t]hree simple conditions: identify the *essential facilities*; give competitors

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4/ *See also MCI Communications Corp. v. American Tel. & Tel. Co.*, 708 F.2d 1081, 1132-33 (7th Cir. 1983) (prerequisite to requiring a monopolist to turn over an essential facility is "a competitor's inability practically or reasonably to duplicate" the facility); Hon. Stephen G. Breyer, "Antitrust, Deregulation, and the Newly Liberated Marketplace," 75 Calif. L. Rev. 1005, 1034 (1987) (because "requiring an inventor . . . to give his secrets away to his competitors discourages innovation," courts have required even bottleneck facilities to be turned over to competitors only in rare instances).

access to them; and make sure competing networks can interconnect with one another." William E. Kennard, "A Broad(band) Vision for America," at 6 (June 24, 1998) (emphasis added). Moreover, once such essential facilities are made available, "there is no need for additional FCC regulation of advanced services, whether offered by the incumbent phone companies or by their competitors," because "competition and consumer demand will take care of the rest." *Id.* at 7.

According to these principles, the Commission should not impose any new unbundling obligations in the context of advanced data services. The Commission's existing regulations under the *Local Competition Order*[5/] already require that incumbent LECs unbundle any bottleneck services and facilities that are not readily available from sources other than the incumbent LEC. Any other facilities competitors need to provide their own advanced services are freely and competitively available; incumbent LECs have no bottleneck control over such items. With respect to xDSL-technology-based services as a class, for example, all of the advanced data equipment used by incumbent LECs can be purchased at market prices from independent vendors. Indeed, U S WEST buys its own equipment for xDSL services from outside suppliers; competitors could buy the same equipment from the same suppliers. As Commissioner Ness recently noted, "[t]he evolving DSL equipment necessary to carry high-speed digital signals on properly conditioned local loops is available to both the ILECs and the CLECs. So is the associated multiplexing and routing/switching equipment necessary to create advanced high-speed data communications services."[6/]

5/ *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, First Report and Order, 11 FCC Rcd 15499 ¶ 873 (1996) ("*Local Competition Order*").

6/ Commissioner Susan Ness, "To Have and Have Not: Advanced

(continued...)

Several new entrants have forthrightly acknowledged that they have no difficulty obtaining the electronics they need to provide advanced services. MCI, for example, has argued:

> CLECs can efficiently provide DSL technologies as sufficiently as US West and other BOCs. . . . A CLEC can place the DSLAM in a collocated space in the BOC's CO just as readily as the BOC can place the DSLAM in its own CO. Upfront investment costs to the provider are low.

Opposition of MCI Telecom. Corp., CC Docket No. 98-26, at 10 n.3 (Apr. 6, 1998). Similarly, Covad CEO Charles McMinn has stated that new entrants do not need unbundled access to nonbottleneck advanced services facilities:

> We are happy if they [the incumbent LECs] don't provide any of the electronics, let us put our own electronics in place, and charge us an appropriately low charge just for the copper line. . . .
>
> Some members of ALTS . . . would go a little bit further and say that when an ILEC deploys DSL services in a central office, the ILEC must provide the CLEC with access to it. . . . We're not insisting on that.

"On the Record: Covad CEO Aims To Make DSL As Pervasive As Current Modems," *Telecom. Reports*, at 44 (June 1, 1998).

Because U S WEST's competitors can obtain needed facilities or technological substitutes from other sources — including network providers in other industry segments using different technologies — they do not need unbundled access to U S WEST's advanced services facilities. They may rely on the market and select among the multiple options it provides (including, of course, the possibility of arriving at a mutually satisfactory arrangement with the incumbent).

6/ (...continued)
Telecommunications Technologies" at 8 (June 9, 1998).

B. The Commission's Charge under Section 706 Weighs Heavily Against Requiring the Unbundling of Network Elements Used To Provide Advanced Services.

The Commission cannot require incumbent LECs to unbundle advanced services facilities without running afoul of its duty under section 706 of the Act "to ensure that the marketplace is conducive to investment, innovation, and meeting the needs of consumers." *Advanced Services Order* ¶ 2. This duty should play a key role in determining the scope of incumbent LECs' unbundling obligations in the context of advanced services. The Commission plainly has the legal authority to apply unbundling criteria that recognize the negative impact an unbundling obligation would have on new investment by incumbent LECs: Section 251 expressly allows consideration of other factors in addition to the "necessary" and "impair" criteria set forth in section 251(d)(2). *See* 47 U.S.C. § 251(d)(2). The *Advanced Services NPRM*, moreover, invites comments regarding other factors to consider in the unbundling analysis in the advanced services context. *See id.* ¶ 181. Forced sharing of innovations indisputably undercuts the incentives for all market participants to invest, and thereby retards the deployment of advanced services. The Commission should not disregard this factor in determining whether new unbundling requirements should be imposed.

As the Commission aptly noted in the *Advanced Services Order*, "[o]ne of the fundamental goals of the Telecommunications Act of 1996 . . . is to promote innovation and investment by all participants in the telecommunications marketplace, both incumbents and new entrants, in order to stimulate competition for all services, including advanced services." *Advanced Services Order* ¶ 1. The core role of investment and innovation in the deployment of advanced services is made clear by the language of Section 706 itself: If the Commission determines that advanced services are not adequately available, it "shall take immediate action to

accelerate deployment of such capability *by removing barriers to infrastructure investment . . . .*" Act § 706(b) (emphasis added).

Requiring an incumbent LEC to share an innovation or investment with a competitor necessarily diminishes and often eliminates the investment incentives of both the LEC and its prospective competitors. An incumbent LEC invests in new facilities (and in research to develop such new facilities) in order to differentiate itself from other market participants. *See, e.g., Kewanee Oil Co. v. Bicron Corp.*, 416 U.S. 470, 480 (1974) (right of exclusivity in a new technology or product provides "an incentive to inventors to risk the often enormous costs in terms of time, research, and development"). Government rules that impair the ability of a carrier to attain this differentiation deprive it of the benefit of its expenditure and thereby destroy its incentive to invest. An incumbent LEC contemplating an investment in an innovation has no reason to make the investment if it knows that the innovation cannot be used to differentiate its services. Similarly, a carrier that knows that it alone must bear the costs of any unsuccessful innovations, while being forced to share any resulting benefits, will not risk experimenting with innovations that might not prove successful.

At the same time, permitting rivals to obtain an incumbent LEC's advanced-service equipment at cost on an unbundled basis inefficiently discourages those *rivals* from investing in *their own* facilities. If a competitor can avoid all research and development risks by waiting to exploit the incumbent's innovative services and technologies, and if it can abandon those innovations at any time without cost or risk should they turn out to be less successful in the marketplace than anticipated, the competitor itself will be discouraged from experimenting, investing, and innovating. *See* Areeda & Herbert, *Antitrust Law* ¶ 771b (if the government "order[s] the [incumbent] to provide the facility and regulat[es] the price to competitive levels,

then the [prospective entrant's] incentive to build an alternative facility is destroyed altogether. . . . [Loss of incentive to build] could be extremely serious . . . in the case where either the [entrant] or some other rival could enter the market by some alternative not requiring the sharing of the [incumbent's] facility").

Chairman Kennard made this exact point in a speech earlier this year to the Federal Communications Bar Association:

> To provide the advanced services, telephone companies will have to invest in advanced electronics. But the telephone companies have rightly asked, why should we make this new investment if we simply have to turn around and sell this new service — or the capabilities of these advanced electronics — to our competitors? If the telephone company has opened up its underlying networks to competition, the competitors can invest in the same advanced services. Where networks are open, I see no reason to require discounted resale or unbundling of these new services and advanced technologies that are available to all.

Chairman William E. Kennard, "A Broad(band) Vision for America," at 5 (June 24, 1998).

The effect of destroying incumbent LECs' incentives to invest in advanced data facilities would be most pronounced in the smaller and more rural communities that have been least able to obtain affordable access to advanced services — the same communities whose interests lie at the heart of section 706. As U S WEST demonstrated in its initial Petition for Relief and in its comments on the *Advanced Services NOI*,[7] the pace of deployment in residential markets and smaller and rural communities significantly lags that in business markets and urban

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[7] *See* Comments of U S WEST Communications, Inc. (Sept. 14, 1998) in *Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps To Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996*, CC Docket No. 98-146 (rel. Aug. 7, 1998) ("*Advanced Services NOI*").

areas. Competitors have been quick to target densely populated areas, but outside these areas the competitive field is virtually empty.

Some degree of disparity is inevitable. High-margin business services and high-income individual users are clustered in urban areas, and — with the exception of future satellite technologies, which have uniform deployment costs — the per-customer cost of building networks always increases as the population density in a market decreases. But the Commission should recognize that its rules often impose additional costs of bringing services to low-density markets that raise the bar so high that it becomes insurmountable. A prime example of such a rule is the obligation to unbundle network elements that are not bottlenecks. Given the costs and difficulties inherent in deploying advanced services to less densely populated areas, the burdens associated with an unbundling requirement decrease the number of communities in which deployment is economically feasible.

The Commission therefore should consider the impact a broad new unbundling requirement would have on the delivery of advanced services, and it should refrain from requiring the unbundling of any nonbottleneck advanced services equipment. Doing so would be consistent with the Commission's obligation to encourage the deployment of advanced services across the board, not just by new competitors in lucrative markets. It is certainly easier and cheaper for a competitor to wait for an incumbent to innovate rather than taking the risk of constructing its own facilities. But a governmental policy that encourages — indeed rewards — such behavior is doomed to harm competition in the long run.

C. The Commission Should Find That Access Services Provided to ISPs Are Not Subject to the Resale Requirements of Section 251(c)(4).

If advanced services *must* be characterized either as "telephone exchange" services or "exchange access" services, the MegaCentral services U S WEST provides to ISPs fall within the latter category. U S WEST plainly sells *access* to ISPs, albeit not to the circuit exchange.[8/] The Commission's rules define "access service" as including "services and facilities used for the origination or termination of any interstate or foreign telecommunication." 47 C.F.R. § 69.2(b). ISPs indisputably purchase MegaCentral services as a means of both originating and terminating the services they sell to end users on a retail basis, making "exchange access" a much closer (though still imperfect) fit than "telephone exchange services."

In precisely parallel circumstances, the Commission determined in the *Local Competition Order* that IXCs are not entitled to resale at a discount when they purchase exchange access services on a wholesale basis. The Commission concluded in that proceeding that "the language and intent of section 251 clearly demonstrate that exchange access services should not be considered services an incumbent LEC 'provides at retail to subscribers who are not telecommunications carriers' under section 251(c)(4)." *Id.* ¶ 873. The Commission reached

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8/ As set forth in U S WEST's *Petition for Relief*, U S WEST believes that a carrier providing advanced services is not providing "telephone exchange" services or "exchange access" services and accordingly does not function as an "incumbent local exchange" carrier subject to the resale obligations of section 251(c)(4). *See U S WEST Petition for Relief* at 45-47 & n.24; 47 U.S.C. § 153(26); *see also* Comments of U S WEST, Inc. (June 18, 1998) in *Petition of the Association for Local Telecommunications Services (ALTS) for a Declaratory Ruling Establishing Conditions Necessary To Promote Deployment of Advanced Telecommunications Capability Under Section 706 of the Telecommunications Act of 1996*, CC Docket No. 98-78, at 15-17. Although the Commission has determined that advanced services are subject to section 251(c), regardless of whether they constitute telephone exchange services or exchange access services, *Advanced Services Order* ¶ 60, U S WEST believes the Commission's decision was incorrect and has sought review of that ruling in the United States Court of Appeals for the D.C. Circuit.

this conclusion about such "fundamentally non-retail services" largely because "access services are designed for, and sold to, IXCs as an input component to the IXC's own retail services." *Id.* ¶ 874. This, in turn, meant that "LECs would not avoid any 'retail' costs when offering these services at 'wholesale' to those same IXCs." *Id.*

Although the Commission has tentatively suggested otherwise, *Advanced Services NPRM* ¶ 189, the reasoning that led it to exclude exchange access services from the section 251(c)(4) resale obligation is directly applicable here. The Commission has noted that ISPs are not "carriers," *Advanced Services Order* ¶ 61, but, regardless of whether an incumbent LEC sells an IXC access to telephone exchange services or sells an ISP access to advanced services, it is furnishing a "fundamentally non-retail service" to which Congress never intended section 251(c)(4) to apply. *Local Competition Order* ¶ 874. In both cases, the incumbent LEC's service is simply a component of a larger service offered to retail customers. Thus, because Congress expressly limited application section 251(c)(4) to "retail" services, it is irrelevant whether ISPs are carriers. They are indisputably wholesale buyers of access rather than retail end users, and that fact alone exempts the provision of DSL services to ISPs from the resale requirement.[9/]

Finally, state commissions rather than the Commission have the ultimate responsibility to determine whether DSL service should be offered to competitors at a discount.[10/] And as a recent resolution by the California PUC demonstrates, states are beginning to recognize

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9/ Alternatively, the Commission may decide that ISPs function as carriers to the extent that they purchase DSL services as "an input component to [their] own retail services." *Local Competition Order* ¶ 874; *see also* 47 U.S.C. § 153(10) (defining carrier as "any person engaged . . . for hire" to transmit energy by wire or radio).

10/ *See Iowa Utils. Bd. v. FCC*, 120 F.3d 753, 795 (8th Cir. 1997), *cert. granted sub nom. AT&T Corp. v. Iowa Utils. Bd.*, 118 S. Ct. 879 (1998).

that advanced services are not appropriate for resale. The California PUC recognized that, "as a new technology that would enhance consumers' need for high speed digital connectivity, ADSL service should be made available to consumers as soon as possible without delay."[11/] But in accordance with that principle and the Commission's analysis in the *Local Competition Order*, the PUC concluded that "ADSL is a form of special access . . . [and,] while special access/private line services are available for resale, they are not subject to wholesale discount."[12/]

II. THE COMMISSION SHOULD NOT CONDITION REGULATORY RELIEF ON AN INCUMBENT LEC'S CREATION OF A SEPARATE DATA AFFILIATE.

The proposal in the *Advanced Services NPRM* to grant regulatory relief only to incumbent LECs that create separate data affiliates represents a cure that is worse than the disease. Structural separation would be more destructive than the unbundling and resale rules that mechanism is intended to alleviate. As described in the NPRM, the separate affiliate proposal would eliminate the efficiencies that integrated provision of POTS and advanced data services allow and thus squander a unique opportunity to introduce such services quickly and affordably to the mass market. *See* Part II.A. At the same time, the separate affiliate proposal ignores Commission precedent. *See* Part II.B. Moreover, the tentative conclusion that an incumbent LEC's transfer of its existing data facilities to an affiliate would render the affiliate an assign (and thus subject to the full array of section 251(c) obligations) might make creation of a separate data affiliate a practical impossibility for U S WEST. *See* Part II.C. The proposal

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11/ *Resolution T-16191. Pacific Bell (U-1001-C). Request To Introduce a New Product, Asymmetrical Digital Subscriber Line (ADSL) Service. ADSL Service Adds High Speed Data Capability to Traditional Local Exchange Service. Pacific Bell Requests the ADSL Service Be Placed in Category III*, at 8 (Sept. 17, 1998).

12/ *Id.* at 9.

could force U S WEST, which has been in the vanguard of carriers investing in advanced data facilities, to duplicate its existing facilities in order to obtain the promised relief from section 251(c). That proposal therefore would penalize U S WEST for its competitive initiatives rather than offer it any regulatory relief. As Commissioner Powell has observed, "[r]egulators can add, revise or eliminate as many policies as they want . . . [b]ut these efforts will be for naught if firms choose not to act on them."[13/] The Commission should refrain from adopting a supposed means of regulatory relief that will in fact be too costly for incumbent LECs to use.

A. Structural Separation Is Burdensome and Inefficient and Would Offer No Offsetting Benefits in the Advanced Services Context.

As shown below, U S WEST and other incumbent LECs have unique economies that allow them to offer advanced services in markets competitors have little incentive to enter. Pursuant to section 706 of the Act, the Commission should be exploiting this potential, not eliminating it. U S WEST will be able to bring advanced services to most of its rural customer base only if permitted the benefits of integrated operation. Yet the NPRM proposes to deny those benefits and replace them with a costly and inefficient separate subsidiary requirement as a prerequisite to even limited regulatory relief.

1. Structural Separation Would Squander the Unmatched Potential of Incumbent LECs To Deploy Advanced Services to All Americans.

Incumbent LECs are uniquely well positioned among common carriers to bring advanced services to the mass market, because their networks reach into virtually all communities — big and small, urban and rural. The existence of extensive circuit-switched facilities will permit economies of scope in the rollout of packet-switched technologies; the

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13/ Commissioner Michael K. Powell, "Somewhere Over the Rainbow: The Need for Vision in the Deregulation of Communications Markets," May 27, 1998, at 5.

efficiencies of integrated provision of voice and data services, in turn, make it possible to provide affordable advanced services to all Americans. U S WEST in particular serves some of the most sparsely populated areas in the country and the most rugged terrain in the continental United States, regions whose high costs of service have deterred new entrants and IXCs from constructing new facilities. Indeed, U S WEST alone serves five of the ten states requiring the greatest monthly per-loop universal support payments, *see U S WEST Petition for Relief* at 6; not surprisingly, those states are among those experiencing the most pronounced bandwidth shortage. U S WEST is committed to deploying advanced data networking and transmission services as broadly as possible throughout its region, and it is the only carrier in its region with sufficient local exchange facilities and mass market experience to realize that goal on a "reasonable and timely basis." Act § 706(a).

Structural separation would eliminate all integrative efficiencies. The NPRM's separation proposal would saddle incumbent LECs' data affiliates with the same array of economic disincentives to serve less well-off communities that new entrants now face. The playing field would indeed be level: *Neither* incumbents *nor* new entrants would be able to justify the economic cost of deploying advanced services to small and rural communities. The new affiliate would be unable to rely on U S WEST's existing ubiquitous network and accordingly, like other CLECs, would be able to serve only lucrative, high-density markets. Thus, the NPRM's separation proposal would fail to tap the potential of U S WEST and other incumbent LECs to deploy advanced services to the mass market.

2. The Commission Has Repeatedly Recognized That Separate Subsidiaries Not Mandated by Congress Are Not Worth the Costs.

The Commission in the past has acknowledged that incumbents can offer consumers more services at lower prices if they are allowed to take advantage of integrative efficiencies. In a closely analogous context, the Commission recognized that "[e]liminating all structural separation requirements and allowing the BOCs to provide enhanced services pursuant to nonstructural safeguards will permit the BOCs to realize fully their vast potential to provide enhanced services to the public, especially to the consumer market."[14/] The Commission articulated the many benefits of integrated operation:

> Removal of structural separation requirements will permit the BOCs to use their extensive resources, including geographically dispersed facilities and the associated management and operational resources, to provide a variety of enhanced services throughout the country. Such an approach will permit the BOCs to use existing marketing contacts with virtually every household within their regions to market enhanced services to consumers inexpensively, to use the same personnel to repair and install the services and equipment necessary to provide basic and enhanced services, and to use their expertise to engage in research and development for enhanced services.[15/]

The Commission also observed that structural separation greatly inhibited BOC provision of enhanced services because it required "duplication of facilities and personnel to provide both enhanced and basic services [and] [i]t impose[d] direct monetary costs, and result[ed] in loss of

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14/ *Computer III Remand Proceedings: Bell Operating Company Safeguards and Tier I Local Exchange Carrier Safeguards*, 6 FCC Rcd 7571 ¶ 6 (1991) ("*Computer III Remand Order*") (subsequent history omitted).

15/ *Id.*; *see also id.* at ¶¶ 99-100.

efficiencies and economies of scope."[16] Imposition of such costs "prevents consumers from obtaining services and service combinations that they desire."[17]

The Commission has reached the same conclusion in other proceedings. With respect to enhanced 911 services, the Commission granted petitions to forbear from applying section 272 of the Act, because "the BOCs realize substantial economies from providing E911 services on an integrated basis that would be lost if they were required to provide those information services through separate affiliates."[18] AT&T also has opposed structural separation on essentially the same grounds: After divestiture, when AT&T was still barred from manufacturing customer premises equipment and providing enhanced services except through a separate affiliate, "AT&T identified costs associated with duplicated facilities and services, which it estimated exceed one billion dollars . . . . It also identifie[d] significant costs created by its inability to offer customers the development and engineering of integrated telecommunications packages that only a facilities-based carrier can provide."[19]

Recent empirical data confirm that structural separation hinders deployment of services and harms consumers as a result. A 1995 study concerning structural separation of

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16/ *Id.* ¶ 8.

17/ *Amendment of Sections 64.702 of the Commission's Rules and Regulations*, 104 FCC 2d 958 ¶ 91 (1986) ("*Third Computer Inquiry*"). *See also id.* ¶ 91 (the costs of structural separation include the fact that "the BOCs are unable to organize their operations in the manner best suited to the markets and customers they serve").

18/ *Matters of Bell Operating Companies' Petitions for Forbearance from the Application of Section 272 of the Communications Act of 1934, as Amended, to Certain Activities*, 13 FCC Rcd 2627 ¶ 44 (1998).

19/ *Furnishing Customer Premises Equipment and Enhanced Services by American Telephone & Telegraph Company*, 102 FCC 2d 665 ¶ 19 (1985).

enhanced service offerings showed that just the startup cost of creating a separate affiliate at that time would have been between $58.7 million and $90.6 million.[20/] Another study demonstrated that structural separation would add at least 30% to the BOCs' costs of developing and marketing enhanced services.[21/] The loss to consumers is even more substantial. Economists estimate that the delays by the Commission and the MFJ court in permitting AT&T and the BOCs to provide voice messaging services cost consumers approximately $1 billion annually in lost welfare.[22/] The economic impact of regulations that prevent carriers from providing consumers with new broadband and Internet services would no doubt be equivalent or greater.

Experience also demonstrates that easing regulations governing an incumbent LEC's integrated provision of advanced services results in a more competitive marketplace. A study of the enhanced services market found that it became more robust and competitive following BOC entry.[23/] BOC entry into voice messaging, for example, caused the previously underserved residential segment to grow rapidly from 1 million subscribers to 4.2 million subscribers from 1990 to 1994.[24/] In particular, the study concluded that many rural and low-

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20/ *See* Clifford L. Fry, et al., *The Economics of Structural Separation from the Perspective of Economic Efficiency*, at 3 (1995) (appended hereto at Tab A).

21/ *See* Jerry A. Hausman and Timothy J. Tardiff, *Benefits and Costs of Vertical Integration of Basic and Enhanced Telecommunications Services* at 21 (1995) ("Hausman/Tardiff Study") (appended hereto at Tab B).

22/ *Id.* at 12-15.

23/ *See generally* Booz, Allen & Hamilton Inc., *The Benefits of RBOC Participation in the Enhanced Services Market* (1995) (appended hereto as Tab C).

24/ *Id.* at III-5 - III-7.